
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Kroll Recommendations Related to the Proposed Guiding Principles for a Structural Budget Deficit Elimination Plan

OVERVIEW

At the Budget and Finance Committee meeting on January 6, 2010, the IBA presented 11 proposed Guiding Principles for developing a Structural Budget Deficit Elimination Plan. In considering the proposed Guiding Principles, Councilmember Faulconer asked if they addressed the budgetary recommendations provided in the Kroll Report issued on August 8, 2006. In order to assist the Committee in their consideration of the proposed Guiding Principles, this report identifies Kroll budgetary recommendations and corresponding proposed Guiding Principles.

FISCAL/POLICY DISCUSSION

Appendix M of the Kroll Report provides a Remediation Plan for the City comprised of numerous recommendations. The IBA has reviewed Kroll's Remediation Plan and identified five budgetary recommendations (numbered and bolded below). Beneath the five identified Kroll budgetary recommendations, we have listed proposed Guiding Principle(s) that are aligned with each recommendation.

Kroll Budgetary Recommendations:

Kroll #20. BUDGET ASSUMPTIONS/MONTHLY BUDGETING

"It is by now beyond dispute the City's planning process and budgeting cannot be counted on to present in comprehensible terms the stark realities the City faces. For over 10 years, through MP-1 and MP-2, the City shortchanged the pension system to avoid the impact of necessary pension payments on current budgets and handed the obligation off to another

generation of taxpayers. Even today there are items in the City's 2007 budget, such as deferred maintenance and the City's post-retirement healthcare obligation, that have the earmarks of another looming fiscal obligation of unknown dimension.

The City should publish, along with the annual budget, the significant assumptions that can materially affect the budget and a comparison of these assumptions against actual experience in recent years. For example, such assumptions ordinarily should include population growth; the number of tax and fee payers; the number, growth and turnover rates of employees; and inflation rates. Any significant variances between actual and projected assumptions should be adequately explained in the final published budget.

The City budget should be presented by month, by department. It should present budget to actual comparisons by department, fiscal year to date, along with variances on a monthly basis. At least quarterly, a report should be prepared reflecting this information in aggregate, with an explanation of significant variances, which is disseminated to the public.

At year end, a budget should be presented to the City Council containing a final budget to actual comparison, along with an explanation of variances by department. Inter-departmental transfers to meet budget goals, or for any other purpose, should not be permitted unless approved in advance by the City Council."

Aligned Proposed Guiding Principle(s):

There is no aligned Guiding Principle as this recommendation refers to a technical budget monitoring process that has already been put into place by Financial Management in its Quarterly Financial Reports and the Office of the Comptroller in monthly financial performance reports as outlined in the City's Budget Policy. A broader Guiding Principle is not considered necessary.

Kroll # 21. FIVE YEAR PLAN

"Because long-range budget planning is virtually non-existent, the practice of addressing short falls in the budget by underfunding long term obligations, such as the retirement system, receives little attention from the Council or the public.

The CFO and Mayor should submit annually to the City Council as part of the annual budgeting process, a rolling five-year proposed plan that contains major items, including (i) capital expenditures; (ii) deferred maintenance; (iii) debt payments and other major contractual obligations; (iv) major sources of revenue; by category; and (v) a forecast of gross cash receipts and gross cash expenditures."

Aligned Proposed Guiding Principle(s):

4. *Prepare a Five-Year Outlook that is structurally balanced each year of the Outlook.*

Kroll # 25. REVENUES AND EXPENDITURES

"Revenue per capita has been increasing, but is less than that of other large cities. In order to maintain current service levels and address issues such as deferred maintenance, the City

must reduce expenditures by improving efficiency, increasing the current revenue base, and seeking alternative revenue sources.”

Aligned Proposed Guiding Principle(s):

1. *Eliminate the General Fund structural budget deficit through a balanced approach of ongoing expenditure reductions and revenue generation, including identifying new revenue sources.*
3. *Actively pursue alternative service delivery methods, efficiency improvements and elimination of service duplications.*
6. *Achieve 100% cost recovery for programs and services that are intended to be fully cost recoverable through fees.*

Kroll # 26. BUDGETING AND FINANCE PRINCIPLES

“The Blue Ribbon Committee found five of the City’s six existing budgeting principles were sound and appropriate. The Blue Ribbon Committee recommended modifying one of the principles and adding two new principles. The Blue Ribbon Committee supported the following existing principles:

- Ongoing expenditures should be supported by ongoing revenues.
- Capital projects should identify all future cost considerations and financial impacts.
- Include direct and indirect costs for each Enterprise Fund.
- Activities supported by user fees should be fully cost recoverable.
- Discretionary General Fund revenues should not be earmarked.

The Blue Ribbon Committee recommended increasing the General Fund reserve from the current level of 3% of the General Fund to the range of 7-10%. The Blue Ribbon Committee also recommended adding two new budgeting principles.

We agree with the aforementioned recommendations. Budget development should be guided by a long term or strategic plan proposed by the Mayor and adopted by the City Council. After adoption, annual budgets should be amended only for urgent needs. Specific funding sources should be identified to pay for these needs.”

Aligned Proposed Guiding Principle(s):

2. *Maintain General Fund Reserve levels at no less than 7% of the City’s General Fund.*
4. *Prepare a Five-Year Outlook that is structurally balanced each year of the Outlook.*
5. *One-time resources should be matched to one-time expenditures.*
6. *Achieve 100% cost recovery for programs and services that are intended to be fully cost recoverable through fees.*
8. *New facilities or programs should only be considered if there is no new impact on the City’s General Fund.*

Kroll # 39. DEFERRED MAINTENANCE AND UNFUNDED PROCUREMENT

“The Blue Ribbon Committee estimated City unfunded deferred maintenance exceeds \$300 million. This includes deferred maintenance related to streets, alleys, sidewalks, street lights, traffic signals, bridges, buildings, and other assets. According to the Blue Ribbon Committee Report, data provided to the Blue Ribbon Committee was incomplete, preliminary, and inconsistent, and thus, the Blue Ribbon Committee was unable to accurately quantify deferred maintenance. However, the Blue Ribbon Committee found that the City’s current funding level was not reducing the deferred maintenance backlog. Instead, the Blue Ribbon Committee found that the City’s current funding level was contributing to the increase in the backlog. The Blue Ribbon Committee was also advised that more than \$170 million in previously unfunded Information Technology procurement was needed over the next five years.

We recommend that the Mayor and the Budget Director establish a process to identify and prioritize deferred maintenance and unfunded procurement needs. The Budget Director should prepare and present a public report identifying cumulative deferred maintenance and unfunded procurement needs during the annual budget hearings. The City’s approach to funding deferred maintenance and unfunded procurement should be changed to allow for increased funding in these areas.”

Aligned Proposed Guiding Principle(s):

11. *Adequately fund deferred infrastructure and maintenance needs annually to ensure that the problem is not growing, and to reduce the potential of increased costs.*

CONCLUSION

In response to comments made by Councilmember Faulconer at the Budget and Finance Committee meeting on January 6, 2010, this report matches proposed Guiding Principles for developing a Structural Budget Deficit Elimination Plan to Kroll budgetary recommendations. This information is presented to assist the Committee in considering the Guiding Principles suggested by our office. Additionally, as requested by Councilmember Faulconer in his memorandum dated January 13, 2010, the IBA is in the process of updating the implementation status of all Kroll recommendations prior to the conclusion of Independent Consultant Stan Keller’s contract in March 2010. It is anticipated that this report will be presented to the Audit Committee on March 8, 2010.

[SIGNED]

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